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Universal Service Reform, State Regulation of Wireless Services, Security of Customer Data, and the Bulk Purchase and Reflashing of Prepaid Mobile Phones

Federal Communications Commission

July 10, 2006

Virgin Mobile USA

- **Virgin Mobile USA (VMU) is a joint venture of Sprint Nextel and Sir Richard Branson's Virgin Group (50/50 ownership).**
  - Allows VMU to leverage both wireless network services from Sprint and the power of the global Virgin brand.
- **Pioneered the Mobile Virtual Network Operator (MVNO) model.**
- **Acquired four million customers in four years since national launch in July 2002.**
- **Eighth largest wireless carrier in the U.S.**
- **Over 30,000 distribution points and 100,000 Top-Up locations, including Best Buy, Wal-Mart, Target and Radio Shack stores.**
- **Employ over 400 people directly; 1,500 indirectly, including agents and consultants.**
- **Expanded grab-and-go wireless service; does not require control of retail stores, sales process or credit check.**

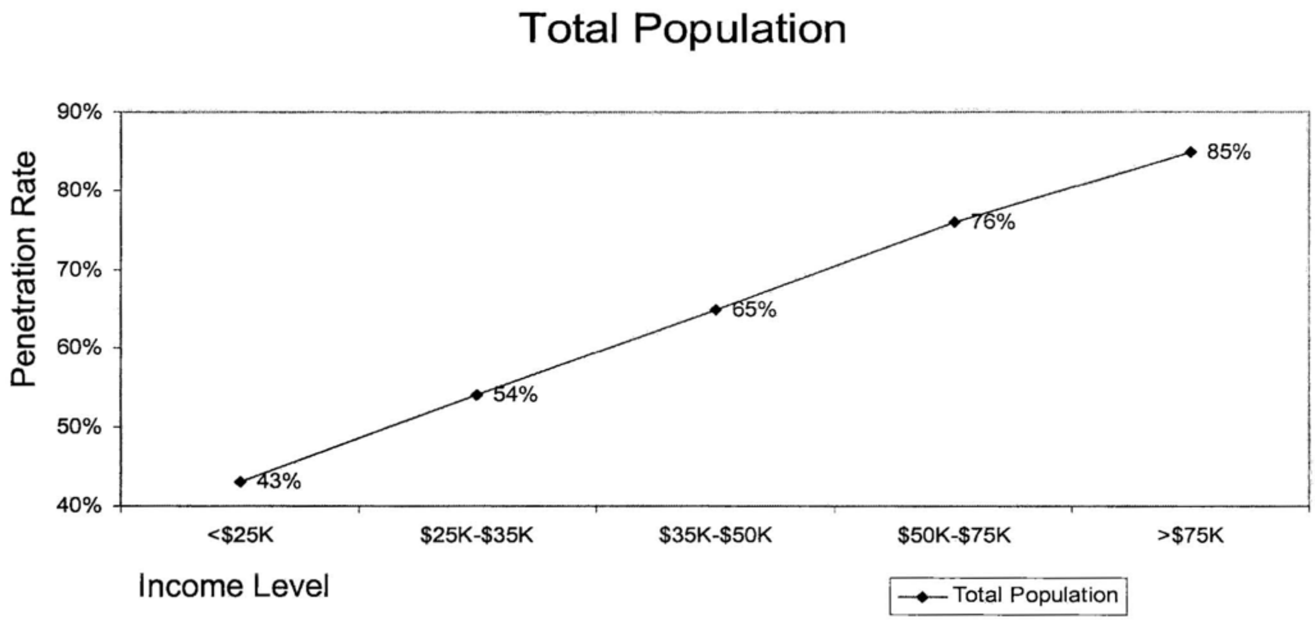
VMU's Customers

- **Customer Profile**
  - 65% of VMU customers are new to wireless.
  - Leading brand in youth market with over 70% brand awareness.
  - High usage of SMS and data services (15% of 2005 service revenues from data).
  - Many customers are from lower-income households that previously did not have access to an attractive wireless service.
    - 35% have household incomes under $35,000.
  - VMU's customer base is diverse: minority representation is twice that of population.
- **Customer Satisfaction**
  - Recognized by J.D. Power and Telephia for outstanding customer satisfaction and care.
  - 92% overall customer satisfaction.[1]
  - 91% of customers would recommend VMU's service to a friend.

[1] MSI Survey of Virgin Mobile Customers, Q4, 2004

Prepaid Market Is More Diverse

- Most wireless operators focus on high-income subscribers because subscription to wireless services is highly dependent on income level:



- Many prepaid customers are lower-usage, lower-income consumers.
- Prepaid services have expanded the availability of wireless services to customers not otherwise able to access wireless service.
- Lower-income customers of VMU obtain wireless service at a good value, without minimum monthly commitments or credit checks, a choice of attractive, competitively priced and subsidized handsets, and access to emergency services on wireless devices.

Overview of USF

- Virgin Mobile supports USF reform to decrease USF contribution obligations from all carriers—while preserving the viability of this important program.
- Connection-based solutions discriminate against providers of prepaid wireless services.
  - Connection-based USF reform proposals would constitute a regressive regime that disproportionately harms lower-income, lower-usage prepaid customers.
  - If the FCC adopts a connection-based approach, it should provide alternatives for prepaid wireless providers:
    - Charge $0.75 connection fee only to "Active Prepaid Handsets" - those generating more than $30 voice ARPU.
    - USF fee waived for prepaid handsets with revenue less than $30.

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Impact of USF Obligations on Lower-Income, Lower-Usage Customers

- Unlike local telecommunications services, demand for wireless services, especially prepaid services, is highly elastic: as prices increase, demand falls.
- Lower-income, prepaid customers are particularly sensitive to the adverse impact of higher USF contribution obligations.
    - Increased USF contribution rates may cause lower-income, prepaid customers to drop their wireless phone service altogether.
- Regulatory policies should spur increased wireless usage rates among lower-income consumers to drive overall wireless penetration higher.

Effect of USF Obligations on Virgin Mobile

- USF obligations impair the benefits of pay-as-you-go wireless services for lower-income customers.
- Increasing USF contribution obligations threaten innovative business models, especially prepaid wireless services.
  - Virgin Mobile does not pass through regulatory fees and taxes to many of its customers. As a result, Virgin Mobile builds regulatory fees and taxes into the cost structure of many of its service plans.
  - In contrast, postpaid wireless carriers pass through USF fees.
  - The burden of increased USF contributions on postpaid carriers, therefore, is partially offset by the corresponding increase in revenue.
  - Increased obligations may force VMU to assess a surcharge on its customers to recover USF contributions.

Connection-Based Fees Would Be Regressive, Forcing Prepaid Customers to Subsidize Higher-Income, Higher-Volume Users.

- Lower-income, prepaid customers would pay a disproportionate amount of a $1/month/connection USF fee.
- Hypothetical postpaid subscriber with $58 ARPU.
  - $1 fee = 1.7% of monthly bill.
- Hypothetical prepaid customer with $20 ARPU.
  - $1 fee = 5.0% of monthly bill.
  - Many VMU customers have less than $10 in ARPU.
- Connection-based proposals would require lower-income, prepaid customers to pay into the USF - <u>even if they had no interstate usage in a given month</u>.
- Prepaid providers would have to recover costs and fees through increased rates or surcharge upon customers.

Alternative Connection-Based Solution

- If the Commission does adopt a connection-based solution, it should reduce the discriminatory burden on prepaid customers by:
  - Imposing $0.75/month/connection fee only on "Active Prepaid Handsets"
  - Handsets that generate at least $30 voice revenue in a month.
  - USF fee waived for prepaid handsets with revenue less than $30.
- Alternative approaches for USF obligations of prepaid carriers have broad political and industry support.
  - The Communications Reform legislation recently approved by the Senate Commerce Committee <u>requires</u> the FCC to adjust its USF contribution mechanism for low-volume customers.
  - Verizon Wireless, T-Mobile and CTIA support alternative approaches similar to Virgin Mobile's proposal.
- The FCC currently waives the Subscriber Line Charge for low-income customers.

State Regulation of Wireless Services

- **State regulation of wireless services has grown increasingly complex and costly.**
  - Most state regulations, taxes, and fees directly conflict with Section 332's prohibitions on regulating the rates/entry of wireless providers.
  - State regulatory fees and taxes raise wireless rates, especially those of prepaid providers that may be unable to pass through costs to customers.
  - Lower-income customers bear a disproportionate burden of per-line, rather than usage-based, state fees and taxes.
  - "Consumer protection" requirements, fees, and taxes threaten Congress' intent to ensure a deregulated wireless marketplace and affect the ability of prepaid carriers to offer services to lower-income customers.
- **Federal Preemption is necessary to protect the wireless market from burdensome state regulation.**
  - Preemption has been effective in eliminating state regulation and spurring the widespread deployment of other services (VOIP, broadband).
  - The FCC correctly preempted state regulation of VOIP and broadband services and should apply its preemption principles consistently.
  - The Communications Reform legislation approved by the Senate Commerce Committee limits the ability of state and local governments to regulate wireless services.

Protection of Customer Information

- Virgin Mobile is an innovator in carrier security procedures and a privacy hawk on behalf of its customers.
  - VMU is the only national carrier that requires a customer password (the "vKey") for every single one of its customers.
  - A customer cannot obtain account information without a vKey or the correct answer to a secret question.
- VMU does not sell customer data, and all vendors that receive customer data to provide services to VMU or its customers must adhere to rigorous nondisclosure obligations.
- Virgin Mobile supports regulatory action that would effectively diminish instances of unauthorized access to Customer Proprietary Network Information ("CPNI").
  - Optional consumer-set password.
- Any regulatory action must provide carriers with the ability to tailor the requirements to their specific business operations.
  - No changes to opt-out regime for uses of CPNI.

The Bulk Purchase and Reflashing of Handsets

- VMU has been the victim of the fraudulent bulk purchase, reflashing and export of its mobile phones.
- Runners buys phones from retailers in bulk and sell them to exporters, who in turn ship them overseas to be reflashed for use on other networks. The bulk purchase and resale activity violates express provisions in Virgin Mobile's Terms of Service.
- VMU sells mobile phones significantly below cost, in part to encourage usage by those who would otherwise be unable to afford wireless service.
  - Without this subsidy, VMU's mobile phones would double or triple in price. As a result, lower-income customers may be unable to obtain wireless service.
- This fraudulent activity primarily affects prepaid rather than postpaid carriers because the latter requires a contract and credit check at purchase.
- Recommended Actions:
  - The FCC should investigate the fraudulent bulk purchase and reflashing of prepaid mobile handsets.
  - The FCC should adopt regulations specifically prohibiting the reflashing of prepaid mobile phones.

Conclusions

- Fundamental reform is vital to achieving the pro-consumer and pro-competitive goals of the USF system.
- Any connection-based solution should take into account the discriminatory effect on providers of prepaid wireless services and their lower-income, lower-usage customers:
  - Impose $0.75/month/connection fee only on Active Prepaid Handsets.
  - USF fee waived for prepaid handsets with less than $30 in revenue.
- Federal preemption is necessary to protect wireless services from burdensome state and local regulation.
- Flexible regulatory action can help to protect the security of customer data.
- The FCC should adopt regulations specifically prohibiting the reflashing of prepaid mobile phones.